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TAGS: EAIR ECON EINV ELAB AR SP
SUBJECT: ARGENTINE FLAG CARRIER AEROLINEAS FOCUS OF
TENSIONS WITH SPAIN

REF: A. 07 BUENOS AIRES 2371
¶B. BUENOS AIRES 64
¶C. 07 BUENOS AIRES 1278

Classified By: Economic Officer Ian Sheridan, reasons 1.4(a) and (d)

¶1. (SBU) SUMMARY. Aerolineas Argentinas (AR) has again become the focus of GOA and Government of Spain (GOS) tensions amidst public accusations by AR Spanish owners Marsans and GOS officials of "harassment" of the carrier. Marsans and the GOS accuse AR unions and some GOA officials of pressing for more GOA or local private sector control of Argentina's flag carrier, and making its operations difficult. Marsans, AR's unions, and the GOA remain at loggerheads; the unions and some GOA officials accuse Marsans of failing to fulfill promises of investment in new aircraft and domestic routes, while Marsans has long demanded that, in order to be profitable, it needs a "no-strike" union pledge, higher tariffs, and tax and fuel rebates. While Marsans again expressed its frustration with local conditions last week, it also publicly signaled its openness to local private sector equity participation. Media reports are drawing parallels to other cases of local investors, close to the Kirchners, taking stakes in formerly state-owned firms that were sold to foreign interests in the 1990s. However, AR's grave financial and operational problems could complicate any new local equity participation. This latest AR conflict could also affect broader GOA-GOS relations. END SUMMARY.

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AR unions and some GOA officials press for local control
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¶2. (SBU) In recent years, the GOA has made no secret of its desire for more local control of the many former state firms that were privatized in the 1990s and sold to foreign investors. While AR unions have expressed their preference for an outright GOA re-nationalization in a bid for more

influence and jobs, the GOA has expressed a preference for a private Argentine-owned entity or local businessperson taking a partial or majority stake.

¶3. (SBU) Argentine flag carrier AR is 95%-owned by Spanish tourism and airlines company Marsans Group. The GOA controls 5%, and in November 2007 exercised an option to purchase another 15%, but negotiations are reportedly at an impasse due to the inability to establish a price for these additional shares. Marsans also owns 100% of the smaller Argentine domestic carrier, Austral. In October 2001, in an agreement involving the GOA, GOS, Iberia Airlines, Spanish state holding company SEPI, and Marsans, SEPI and the GOS, controlling AR at the time, assumed AR's accumulated debts of about $700 million in exchange for Marsans to take over the ailing airline.

¶4. (C) According to Spanish Embassy contacts (and media reports), Transportation Secretary Ricardo Jaime, a close aly of former President Kirchner, has been a leading proponent of encouraging a local businessman to come forward to take a stake in AR. Many Kirchner-allied business names have emerged, including airports operator Eduardo Eurnekian, train concessionaire Ricardo Cirigliano, ferry operator Juan Carlos Lopez Mena, banker Jorge Brito, and small local airline owner Carlos Avila. However, according to the Spanish Embassy and media reports, in fact, no one has approached Marsans, and media reports wonder if this push might be more inspired by some factions in the GOA. According to a La Nacion columnist, it is the GOA who wants local players to control AR, but local players are largely not interested in running AR.

Marsans and AR's unions at an impasse

¶5. (SBU) Marsans has long been accused by unions and some in the GOA of not complying with promises for new investment in aircraft, domestic routes, and pilots. In response, Marsans has said that it wants to invest and expand AR, but needs a multi-year "no-strike" union pledge (ref A), which the unions have resisted. Marsans has also long requested of the GOA higher fares and a long-promised package of tax and fuel rebates in order to be profitable. Without these assurances, Marsans has threatened to decrease its investments and focus its efforts elsewhere, or even leave Argentina altogether.

¶6. (C) AR unions, because of their position in such a strategic industry (and the support of a labor-friendly government), carry a lot of clout. They do not hesitant to resort to strikes and slowdowns to gain wage and other concessions (ref B). In recent years, they were successful in ousting the previous AR president, Antonio Mata, whose tough bargaining style they criticized. The unions also succeeded in pressuring AR to fire 70 experienced pilots who had resisted supporting the unions' 10-day strike in 2006 (that cost the airline $5 million in indemnifications). AR unions also stand accused (including by the GOS) of intentionally making Marsans's working conditions more difficult and operating costs higher, through frequent strikes and slowdowns, presumably to encourage Marsans's exit, thus making any sale at a lower price for either the GOA (what the unions prefer) or a prospective local businessperson. In fact, AR's financial and operational conditions are worsening by the month.

Marsans and GOS express frustration

¶7. (SBU) Last week, Spanish Ambassador Rafael Estrella publicly deplored the "campaign of destabilization and harassment" of AR, and warned it could affect bilateral relations and Argentina's image in Europe. (At the same time, the GOS pointed out that, as a private company, Marsans and its problems do not necessarily directly affect broader GOA-GOS relations.) GOS Foreign Minister Moratinos also is

reported to have expressed his "uneasiness" and "concern" that AR has been taken "hostage" by the unions. Soon thereafter, Marsans announced that it was open to a form of "Argentinization" of the airline, but one that does not jeopardize "the opportunities and business knowledge that Marsans brings."

Part of a pattern

¶8. (U) Media reports are drawing parallels to similar cases in recent years of local investors close to the Kirchners taking stakes in state-owned firms that were privatized in the 1990s, which had run into post-crisis trouble amidst price freezes and a difficult investment climate. (This is allegedly an explicit Kirchner strategy.) Gas and oil giant YPF, Argentina's largest power distributor Edenor, and Telecom appear to fit this pattern (and there is speculation that Telefonica could be next), although comparing them to AR might difficult because these firms have largely been profitable, whereas AR has never made money. Others argue that the foreign investors are also partly motivated by a desire to reduce exposure to the difficult Argentine business climate, while also bringing in well-connected partners with an open door to the GoA. Septel will discuss this apparent

new possible form of local and state control of some former state firms.

¶9. (U) Spanish oil and gas giant Repsol-YPF recently sold a 15% stake in its Argentine subsidiary YPF, once GoA-owned, to Argentine banker and Kirchner insider Enrique Eskenazi, for $2.25 billion (ref C), in a deal that former Economy Minister Roberto Lavagna called "crony capitalism." In 2003, France Telecom sold most of its shares of Telecom Argentina, the first major divestiture of a foreign firm from privatized services. It sold its 48% stake of the holding company that controls Telecom Argentina to local investment company Werthein Group for $125 million. The comparatively low price reportedly reflected Telecom's heavy debt burden and tough operating conditions. In 2005, local investment firm Pampa Holdings bought a 65% stake in Edenor from Electricite de France (EDF) for $100 million, a dramatic drop from the $800 million EDF paid for a 45% stake in 2001. Shortly after Pampa's purchase, Edenor obtained a 28% tariff increase. Some analysts attributed the low purchase price and after-sale tariff increase to the GOA's preference for local participation in this sector.

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AR's grave challenges could complicate any takeover
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¶10. (U) While AR's finances are not widely disseminated, local financial journal Apertura recently estimated its 2007 losses at $100 million, on $1.3 billion turnover, with first quarter 2008 results trending even worse. Other media reports estimate AR's 2007 losses even higher, at close to $200 million, with March 2008 losses at $15 million. AR is reportedly in arrears for $60 million to airports operator AA2000, and several months behind to other providers and creditors. According to one local aviation consultant, AR has rarely, if ever, been profitable in its 58-year history. Losses in recent years have been absorbed by GOA taxpayers in the form of tax and fuel subsidies, and cash infusions. The same Apertura study revealed that AR, with over 9000 employees, has 200 employees per plane -- compared to the regional average of 100 -- and the average age of its varied fleet is 20-25 years -- compared to the regional average of
¶10. According to the former GOA under secretary of commercial air transport, although AR's fleet numbers about 60, only around 30 planes are currently operational.

¶11. (SBU) Part of AR's woes can be attributed to problems over which it has no control: price caps that place its fares at one-third to one-half the regional average, and unions that stage frequent strikes (ref B). Any prospective new

owner would conceivably face the same constraints, unless they find a more cooperative government attitude. If AR could resolve these problems, in the long term it has great potential: AR controls about 80% of domestic traffic in a vast and tourist-rich nation ripe for growth, has lucrative routes to Spain, the United States, and Latin America, and has a long history of commercial aviation.

¶12. (C) Assessing AR's value is difficult: its shares are not publicly traded, and GOA decisions that have a direct impact on its implicit or explicit value, such as fares, fuel prices, taxes, subsidies, and routes, are made non-transparently. Embassy of Spain contacts confirmed that as AR is run today, it is not profitable, and will not be so as long as issues related to taxes, fares and union "social peace" are resolved. Although the GOA recently granted an 18% domestic fare increase, the Embassy said that even this measure would not alleviate AR's financial woes.

Impact on GOA-GOS relations

¶13. (C) Spain is Argentina's top foreign investor, reflecting close Spanish-Argentine cultural, linguistic, and familial ties. Spanish investors took a leading part in Argentina's 1990s privatization wave - with mixed success - taking controlling or minority interests in some of the many state-owned public services such as telecoms, electricity, gas, banking, water, rails, highways, ports, mail, airports and commercial aviation. Marsans faces problems similar to those faced by other foreign investors: GoA-mandated below-market tariffs, an uncertain regulatory and investment climate, and exploding energy and salary costs that are squeezing margins. In this situation, local pundits argue that Marsans might come to the conclusion that a local and well-connected shareholder could help it navigate these problems.

¶14. (SBU) Political affinity (both governments lean leftwards) has perhaps contributed to the GOS's being patient with the GOA, despite these commercial disputes and difficult operating conditions. In January 2007, the GOS cut Argentina a special side deal for the latter to pay its $982 million debt to Spain, over six years, including a 3-year grace period, and outside the Paris Club. However, patience might be wearing thin. Local media has alleged that the new GOS Minister of Industry Miguel Sebastian is close to Zapatero and Marsans, and "not a fan" of the Kirchners or their policies. Marsans principals are also leading members of Spain's most important business chamber, CEOE, and problems with AR could affect the GOA's reputation in Spain.

¶15. (C) On April 27-28, Spanish Foreign Minister Moratinos was in Buenos Aires to attend an "Alliance of Civilization" conference, a GOS initiative scheduled long before this latest AR flare-up. Although there was a lot of media speculation that Moratinos would deliver a message of protest regarding AR, Moratinos said upon his arrival that he did not come to "pressure" Argentina on AR, and said that it was a private sector matter anyway. However, the Spanish Embassy later confirmed that the AR was discussed, but was "not a priority issue."

Comment

¶16. (C) This latest flare-up over AR will likely not be the last. On the Argentine side, while much of the action is behind the scenes, it seems quite possible to us that both the unions and GOA have a role in encouraging the conflict, albeit for different reasons. The unions hope for a GOA re-nationalization, which would translate into more union influence and jobs. But the GOA has roundly ruled this out, while some GOA factions are encouraging a local investor to take a stake in the airline. While the GOA might portray

such a deal as the private sector "regaining" control of a strategic sector, others see it as just a form of crony capitalism. Some Argentine pundits allege the existence of a GOA conspiracy to drive down the price of AR until Marsans accepts an Argentine investor, presumably one who is favored by the Kirchners -- very much along the lines of how these same pundits portrayed the set of circumstances that led to Repsol-YPF's "sweetheart" deal for Kirchner crony Eskenazi.

¶17. (C) However, AR's grave financial and operational problems could complicate any easy transition. The heart of AR's problems is not so much the unions or even Marsans, but how domestic aviation is run in Argentina today, with frozen tariffs, high fuel and salary costs, and the apparent need of

aviation companies to spend valuable time and resources fighting the GOA every step of the way.

¶18. (C) AR problems aside, GOA-GOS relations are largely positive, and they hope that the relationship will not be negatively impacted by this dispute. Although we do not know what Moratinos specifically said in private about AR, last week's Spanish Embassy and Foreign Ministry public statements made very clear the GOS's displeasure, while it was also not surprising that this displeasure was then diplomatically toned down by Moratinos in Buenos Aires.

¶19. (SBU) The GOS's relatively mild protest about AR's treatment is likely the best it can do right now given AR's delicate situation. AR's problem will likely simmer longer, and could erupt again in the near future. Given that there are no easy fixes, the GOA might very well calculate that keeping the status quo with AR might be their least bad option at this point. The GOA might choose to just let AR keep limping along, in the hope that more serious problems do not occur. As with so many other pressing issues facing the GOA, it might just opt to just kick the can down the road for another day.
WAYNE